Practicing CPA, vol. 26 no.4, June 2002

American Institute of Certified Public Accountants (AICPA)

PCPS 25th Anniversary

The Practicing CPA

PCPS
THE AICPA ALLIANCE FOR CPA FIRMS
WWW.AICPA.ORG/PCPS

JUNE 2002

WHAT'S INSIDE

American Institute of Certified Public Accountants

AICPA

CONSOLIDATION CONTINUES: POSITIONING THE SMALL FIRM

How to prepare for it—or defend against it

By William Pirolli

Several years ago, consolidation of the accounting industry started as a whirlwind sweeping through some of the largest firms in the country. Although that whirlwind has diminished to a breeze, with some successes and failures, our industry, and those who would participate in it, still find themselves working out the major issues of consolidation.

During the height of consolidation activity there appeared to be no end in sight. You could almost envision the formation of super firms, owned by financial giants, threatening the very existence of regional and smaller firms. Many of us looked to banks and the insurance industry as future consolidators. Reality has proven to be quite different.

So is this a post-mortem for consolidation? Hardly. There is still much activity among regional firms that initially were not targets of the consolidators, producing many exciting opportunities—or threats—for small firms.

For purposes of this article, the focus will be on small and regional firms. By AICPA criteria, a small firm is one with fewer than ten professionals. These firms include sole practitioners, and small multipartner firms, as well as larger firms whose reach is generally within a local geographic region. Regional firms vary in size, but, for purposes of this article, consider them to be in the range of 20 to 75 professionals.

The regional firm challenge: acquiring critical mass

Regional firms generally provide a wide range of services including traditional tax and audit, specialized consulting such as elder care and business valuation, personal financial planning, litigation support, information technology, merger and acquisi-

→

tions, and many other services. They may typically belong to a national organization of allied firms and their service reach may extend far beyond their own back yard.

Legislation regulating commissions and contingent fees in many states allowed these firms to expand into commission-based products such as investment management, insurance, mortgage origination, and payroll processing. In short, these multidisciplinary practices are attempting to leverage their client base by forming a one-stop financial resource.

The challenge for these firms is to acquire a sufficient critical mass of clients and sell these new products and services to them. In many cases, the firm may not have a sufficient internal client base to carry each new department. The choice then is between marketing for clients one at a time in traditional fashion or consolidating other firms and leveraging the new client base.

The small firm dilemma

What are the options for small firms? In today's market you can choose to embrace the opportunities of consolidation or remain independent. For many, the latter option works fine. I believe the role of the small practitioner is strong and will remain that way for many years to come.

Your geographic location and client demographics may mean that consolidation will never be an issue for you. That said, however, there is never a time when you can ignore market forces and the demands of your clients. You should always seek to provide quality services and be competitive in your marketplace.

If you perceive there is opportunity for your firm in consolidation there are many ways to enhance your attractiveness.

Get in the game

Preparing for consolidation will be a different challenge for every firm. The first step for everyone, however, is to evaluate who you are and determine your strengths and weaknesses. This means compiling your firm's client and financial demographics. According to consolidators, the primary reason deals fail to get off the ground is the lack of solid administrative procedures and firm and client demographics. At a minimum you should have the following information available:

- Average firm billing rate
- Firm utilization and realization rates
- Charge hours per professional
- Services and fees by category (corporate, personal, etc.)
- Analysis of possible specialties or niches
- Solid client demographics (size, service, industry)

There are many other indicators. Consult the AICPA MAP Handbook for the data gathered in the Texas Survey of firms. You must understand your own firm's financial data. It is critical to anyone who will be analyzing your practice for consolidation.

Burnishing your image

For a small firm, the reality is that you are a piece of someone else's puzzle. By consolidating your practice, a larger firm is trying to build critical mass for its own firm. It may in fact be filling a mandate to grow if it has already been consolidated itself. It may also be positioning itself to be consolidated in which case volume and profitability are the rule.

Keep in mind the consolidators' motivations. Yes, they are acquiring your firm. More important, however, they are buying direct access to your clients and your staff. The better your clients and the more highly trained your staff, the more attractive your firm will be.

Better does not necessarily mean bigger. A good client is one to whom additional services can be sold. Concentrations in particular industries can also be very valuable to a larger firm trying to fill holes. It is critical that you understand who your clients are and why they are valuable to someone else who is not interested in providing only traditional services.

Planning is the key. It is impossible to change your firm's direction quickly. Old habits are hard to break but you need to start. Your goal is to make yourself as attractive as possible to a consolidator. Even if you never consolidate your firm, taking action can only make your firm more profitable. Consider the following.

The Practicing CPA (ISSN 0885-6931), June 2002, Volume 26, Number 4. Publication and editorial office: Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881. Printing and mailing paid by PCPS/The AICPA Alliance for CPA Firms. Opinions of the authors are their own and do not necessarily reflect policies of the Institute.

Editor: William Moran

- Prune the tree: Eliminate marginal clients.
- Phase out low end services.
- Adjust your rates upward over a period of time.
- Concentrate on your utilization and realization rates.
- Practice efficiently to enhance profits.
- Expand upon any niches or specialties you may have.
- Develop solid administrative procedures.
- Make your firm more visible in the accounting community.
- Keep current of trends in both national and local marketplaces.
- Consider adding non-traditional services to enhance value.
- Consider mergers or acquisitions to build volume.
- Keep staff well trained, and promote future leaders.
- Join an association.

Less is more

Once you have "dressed up" your practice you will need to understand what to expect from any consolidation. Expect less. Your firm will not be worth what you expect unless it is highly profitable or has some major client or industry attraction. If your firm's annual gross billings are $1 million and your consolidator's are $10 million, you are not worth 10 percent of their value. Their average partner compensation and billings may very well be twice yours and, as such, they value your gross less than theirs.

Actual numbers are elusive. But conversations with larger firms that are currently consolidating smaller firms suggest that you may be hard pressed to realize one times annual gross. The trade off is long-term security and an attractive compensation package.

Keep in mind that consolidation is not a retirement purchase. It assumes continued effort on your part. Adjust your expectations and remain open minded. The total package is probably more than if you were not proactive and simply sold a less than attractive practice.

A new role

Your role will change. You will be expected to leverage your clients with the new products and services available to you. In short, you will be expected to sell to your clients and produce non-traditional revenue for your new firm. This role may be new and even uncomfortable. At the heart of the process is providing the client with a wider range of quality products and services from their most trusted adviser — you.

Assuming a solid upstream consolidation, you most likely will not participate at the top level of firm management. Many practitioners view this as a distinct advantage.

Choosing to Go It Alone

A common trait of small firms is fierce independence. Many practitioners began their careers at larger firms and are not eager to return to that culture.

Although the future of independent firms is strong, what is up for debate is what firms of the future will look like. Clearly clients have more options available for basic tax and accounting services. Tax preparation, with advice, is now available for free on the Internet. Programs such as Quick Books have also changed the landscape.

Clients still rely on CPAs as their primary source of financial advice but we need to adapt to their needs. The client of tomorrow will be more sophisticated and continue to challenge our profession to provide different and innovative services.

As an independent, you will face competition in the future from the new firms being molded today. Just like firms looking to be consolidated, you will need to examine your firm and be prepared to adapt. To succeed on your own, consider some of the following:

- Develop a niche.
- Consider new services, such as investment counseling, and college planning.
- Develop a strong network with other independents.
- Form a practice group.
- Form a strategic alliance with another firm.
- Develop a practice continuation plan.
- Seek independent review of your firm practices.
- Focus, focus, focus.

Eliminating management and administrative responsibilities allows the practitioner to become more efficient.

Structuring the deal

The current marketplace provides a variety of consolidation options:

- *Straight purchase.* Payments are based upon traditional valuation methods payable as deferred compensation depending on client retention. A short-term employment contract to aid in transition may be included. This is not a true consolidation.
- *Equity merger.* Your firm is valued as a part of the whole. You will become a stakeholder in the consolidating firm. This arrangement assumes a long-term commitment with an employment contract.
- *Combination.* This arrangement provides for both cash and equity and involves a long-term commitment.

continued on page 4

continued from page 3

The better positioned your firm is the more negotiating power you have. Take a big picture approach and be willing to be flexible.

All dressed with nowhere to go

Finding the right firm consolidation partner is critical. Firm culture is a key component and sometimes proves to be a major stumbling block. Your new partner must share your philosophy towards performance and client service. Unhappy staff and clients will not make for a smooth transition, so the culture of their new home is important.

How do you find the right fit?

- Make your firm visible in the accounting community.
- Spend time with all partners of the consolidating firm.
- Get involved with your industry on a state and national level.
- Be proactive. Meet with major firms in your area and sell yourself.
- Consider a strategic alliance first: It is the courtship before the marriage.

Looking forward

Although consolidation has faded from national attention, it is still alive and well. Small firm practitioners are uniquely positioned to capitalize on the trend towards developing multi-disciplinary practices by larger firms. Whether you choose consolidation or independence, the future of your firm and our industry has never been brighter. ✔

*—**William R. Pirolli**, CPA, is managing principal at Pirolli, Deller & Conaty, CPAs, a small firm in Warwick, RI. He is a past member of the AICPA Small Firm Advocacy Committee and Chairman of the MAP Committee task force on Consolidation and the Small Firm. A frequent speaker on issues related to small firm management, he can be reached at wpirolli@cpaadvise.com*

STAFFING CPA FIRMS IN THE INFORMATION ERA

By Eric E. Lewis, Jeffrey W. Lippitt, and Nicholas J. Mastracchio

Dramatic changes in information processing over the last decade have affected accounting firms in several ways. The audit portion of the practice has shifted from tests of transactions to control testing and process documentation. In addition, firms have expanded into several assurance service areas, and management consulting has continued to expand as a source of fees. These shifts have necessitated a change in the basic skills that practitioners look for in their staff. Firms are telling educators that they must respond to the new environment and change the competencies of their graduates. What is the effect on staffing and profitability?

To address this question, we gathered data at a Practitioner's Symposium. We began by establishing standard staffing levels for CPA firms. We then ranked all firms from highest to lowest based on net income per owner. Staffing levels were significantly different between the lowest and highest groups.

The data represent 83 firms with gross fees ranging from \$200,000 to \$14,000,000. The median firm had \$1,850,000 in fees. We used survey staffing levels for each firm in the following categories: owners, professionals, paraprofessionals, and support.

One of our goals was to develop standard staffing levels for each staff category for any size firm. We used chargeable hours as a measure of firm size.

The "typical" practice

We used a regression analysis to predict the staffing of a "typical" practice. One question was "Based upon the survey information, what would the staff look like in a typical firm?" The standards, which we developed based on our findings, represent a typical practice rather than an optimally staffed practice. In other words, the results allow firms to compare themselves to each other, but do not necessarily represent the best staffing. Staffing levels for top performing firms are presented later in this study.

The regression provides a formula that starts with a constant number, the intercept, and adds an increment based upon size. The increment indicates how many people at that level must be added based on the total chargeable hours of the firm. Exhibit 1 shows the formula. To use the formula, divide the total number of chargeable hours of the firm by the incremental chargeable hours per

Exhibit 1

Predicted Staffing Firm With 50,000 Chargeable Hours

Category	Divide Chargeable Hours by Incremental Hours/ Additional Person	Add Intercept	Total
Owner	9,686	1.489	6.65
Professional	2,297	(0.725)	21.04
Paraprofessional	15,653	0.434	3.63
Support Staff	4,771	0.434	10.91

Exhibit 2

Predicted Staffing Top and Bottom Third With 50,000 Chargeable Hours

	Top			Bottom		
Category	Divide Chargeable Hours by Incremental Hours/ Additional Person	Add Intercept	Total	Divide Chargeable Hours by Incremental Hours/ Additional Person	Add Intercept	Total
Owner	10,591	1.08	5.80	7,087	1.19	8.25
Professional	2,269	(0.24)	21.80	3,186	1.13	16.82
Paraprofessional	4,814	0.28	3.65	11,089	0.29	4.80
Support Staff	5,091	0.41	10.23	4,048	0.20	12.55

person and then add the intercept term. For example, to predict the typical number of owners reported in the survey, 1.489 would be added to one additional owner for every 9,686 hours. Exhibit 1 also illustrates the typical staffing for a firm that has 50,000 chargeable hours.

Distinctions by performance

We ranked the firms from highest to lowest based on net income per owner. Breaking the sample into three groups, we developed a test to see whether there were differences in staffing levels between the high and low performing groups. We observed significant differences between these two groups.

Exhibit 2 presents the predicted staffing level for each group. It also provides an example for a firm with 50,000 chargeable hours. The groups showed fairly significant differences in the owner and professional staff levels, with the top group having fewer owners and more professionals for a given number of chargeable hours. The apparently large difference in the paraprofessional category is not statistically significant because of the wide variation in the use of paraprofessionals among all firms in the study.

Differences in the use of support staff reflect the differences in the owner category. The importance of the different staffing norms between the top and bottom groups is reflected in the fact that the top group enjoys an average net income per owner of $246,145 while the bottom group averages only $102,824 per owner.

The results demonstrate the power of leverage on partner income. One might also attribute the difference to the type of practice involved or staff productivity. The study does not indicate, however, that this is a significant factor in distinguishing the top and bottom group. Exhibit 3 compares type of practice and the percentage of chargeable hours.

Exhibit 3

Services and Productivity by Performance

Performance Group	Audit	Tax	Review and Compilation	Other Accounting Services	MIS and Other Consulting	Percent Chargeable
Top	17%	36%	15%	12%	20%	60%
Bottom	18%	36%	14%	13%	19%	59%

Clearly staffing levels play a significant part in partner profitability. Exhibit 2 can be used as a benchmark in evaluating current staffing levels against the top firms. These calculations are best suited to firms with between 10,000 and 180,000 chargeable hours. This benchmark, although not necessarily providing an ideal staffing profile, represents a "best practice" standard for CPA firm staffing. Since chargeable hours very ably explained the number of people in each category, we can conclude that there is consensus among the top performing firms concerning the appropriate number of people in each category for a given firm size. ✔

*—**Eric E. Lewis** is Assistant Professor of Business at Skidmore College, Saratoga Springs, New York 12866 (518-580-5110; elewis@skidmore.edu). Jeffrey W. Lippitt is Associate Professor of Accounting at Siena College, Loudonville, NY 12110 (518-783-2464; Lippitt@siena.edu). Nicholas J. Mastracchio is Associate Professor of Accounting at University of Albany, Albany, NY (518-442-4974; Mast@nycap.rr.com).*

BUILDING AND KEEPING AN EFFECTIVE REFERRAL NETWORK

How to follow through and maintain control of the contact-making – relationship-building process

By Allan S. Boress, CPA, CFE

Most CPAs tend to be all-consumed with getting the work out. Consequently, they often fall down in controlling the referral contact process needed to build an effective network. Effective personal contact, however, will be the primary factor in determining who gets the limited number of quality referrals that are handed out.

Effectively and powerfully managing contact making

In more than 20 years of providing sales consulting services to our profession, we have worked with many of the top business producers. Here is what you can learn from them regarding mastering the contact-making process:

- *To keep your contacts' attention, follow through immediately after meeting with them.* Most professionals meet someone and that's it. Sure, the impression you make may be highly positive. But it is definitely as temporary as your memory of what you ate last Tuesday evening for dinner. Never expect anyone to remember you or what you do.

Rather, separate yourself from the vast majority of your competitors by following up immediately when you meet someone you want to help you. Send them your brochure, your business card, and a personal note.

- *Plan on some form of communication at least monthly, whether it is a personal meeting, phone call, sending an article, or such.* "Out of sight, out of mind, out of luck" is my marketing rule. Do more than merely send your contacts your newsletter once in a while. Invite them to seminars, social events, and similar contact opportunities. Maintain personal contact with them.

No, you won't be perceived as a nuisance if the contact is casual and varied. Leave voice mail messages. Send an article that will interest them. Call them up just to see how they are doing and if they heard the latest news story affecting their business.

Often the person who gets the quality referral is the one who had the most contact with the referral source or client, not necessarily the most competent to do the work!

- *End your meetings with commitments to action.* I run into so many professionals who have met with referral sources and others who could have helped them, but they neglected to complete their meetings with decisions on how to proceed with the other person.

You always need to know, and they do as well, exactly what happens next. Will there be an introduction? Are you going back to your offices to search client databases for people to introduce to each other? Are you going to refer your attorney referral source to this banker? How? When? Don't leave things hanging in the air at the end of meetings, because tying together loose ends later on is much more time consuming and difficult.

Unless, of course, the contacts are unwilling to help or move forward, open-ended meetings result in ambiguity. And because the other person doesn't know what to do next, he or she forgets about you and your meeting immediately. Complete meetings by placing your next contact dates on your calendars.

When you end a meeting with someone who can help you, and vice versa, make sure you create the logical next step:

- The next time you will make contact.
- When, specifically, introductions will be made.
- How to proceed with joint marketing efforts.

Information is valuable!

You need to maintain a detailed database to fully capture the value and control the assets in your personal inventory. This is an additional time and paperwork burden, but the best business generators apply their accounting skills to their networking as well. You may learn later on that you have few more important assets than this. This is an investment you have to make in your success.

Here are various kinds of information you need as an example for a simplified but effective networking contact record-keeping system. Contact management programs such as Act or Microsoft Outlook work well for this purpose.

- Name of contact
- Title
- Company name
- Address
- Telephone
- Fax
- Email
- Web site address
- Source of contact originally
- Notes on company
- Notes on contact: (history, networks, personal interests)
- Record of meetings or contacts with this individual

Letters to the Editor

The Practicing CPA **encourages its readers to write letters on practice management issues and on published articles. Please remember to include your name and telephone and fax numbers. Send your letters by e-mail to pcpa@aicpa.org.**

- Introductions received from this person
- Introductions given to this contact
- When and how you thanked this individual

Being adept technically at controlling your contacts is invaluable to effectiveness and results. The top business producers consider this to be a major factor in their success. You can too!

*—**Allan Boress**, CPA, CFE trains CPAs and professionals in the art of systematic selling, personal marketing, and client retention since 1980. He is the author of* How to Master the Art of Marketing Professional Services. *Web site at www.ibate-selling.com; phone: 954/345-4666.*

AICPA BUSINESS VALUATION STANDARDS SLATED FOR PRE-EXPOSURE COMMENT

CPAs who perform business valuations will soon have authoritative standards to follow. The AICPA Business Valuation Subcommittee and its Business Valuation Standards Task Force expect to release a draft of the new Standards for pre-exposure comment by late summer in 2002.

The draft will be sent to all CPAs who have earned the AICPA's Accredited in Business Valuation (ABV) designation, the AICPA Consulting Services Executive Committee, the Business Valuation Subcommittee, the Business Valuations Standards Task Force, representatives of public accounting firms, representatives of the Internal Revenue Service, and other individuals and groups.

A revised draft of the Standards will then be issued for public comment within another six months. The Standards will be published by the Business Valuation Subcommittee, chaired by Thomas E. Hilton, CPA/ABV, on behalf of the AICPA Consulting Services Executive Committee.

When the new Standards are issued, they will apply to all CPAs engaged in business valuations, not only to CPAs who have earned the ABV designation or to CPAs with business valuation credentials from other organizations.

The Standards Task Force, chaired by Edward J. Dupke, CPA/ABV, developed the Standards draft after intensive analyses of standards issued by the American Society of Appraisers, the National Association of Certified Valuation Analysts, the Institute of Business Appraisers and other organizations.

All CPAs will still be bound to comply with the AICPA Code of Professional Conduct rules 102 and 201 and the Statement on Standards for Consulting Services No. 1. The new Business Valuation Standards will provide CPAs with definitive rules for providing services in the growing business valuation profession. They will also aid in affirming the ABV as the premier business valuation credential.

For more information about the Standards, contact James C. H. Feldman, CPA/ABV, AICPA Manager of Business Valuation and Litigation Services at jfeldman@aicpa.org. For information about obtaining the ABV credential, contact Madelaine Feldman, AICPA Examinations Coordinator, at mfeldman@aicpa.org.

PCPS UPDATE

PCPS INVITES YOU TO ATTEND STRATEGIC ASSESSMENT TRAINING!

Are you interested in becoming a Strategic Assessor? PCPS invites you to learn an innovative new set of skills to offer a valuable new service to your clients!

Strategic Assessment is a service designed to help CPA firms review and evaluate the components of a strategic plan to determine if they function in a way that is optimal for achievement. Become a compass for your clients. Strategic Assessment training will give you the insight to help your clients determine if the road they've mapped out will lead to success.

Strategic Assessment can be done effectively for CPA firms as well, so if you believe your firm's strategic plan could use some fine tuning, (or if you'd like to consult with CPA firms on this topic) this training is for you!

As a Strategic Assessor, you will learn to:

- Examine your clients' mission statements and marketing plans.
- Make effective recommendations regarding business processes.
- Assess realistic business and administrative goals.

The next Strategic Assessment training session will be offered at the August Peer Review Conference in Dallas. To find out more or to register for training, contact us at 1-800-CPA-FIRM.

Correction: Sue McCormick Address Change

In our March/April issue, the address we included in the MAP Network Groups section for Sue McCormick, Chair of the MAP Medium Network Group, was incorrectly stated. The correct address is:

Susan McCormick
Casey, Peterson & Associates
505 Kansas City St
Rapid City, SD 57701

A REAL FIND FOR RESEARCHERS

FindArticles: http://www.findarticles.com

By Eva Lang, CPA

FindArticles, a joint venture of the Gale Group and LookSmart, is a database of the full text of published articles from approximately 300 magazines and journals dating from 1998. While the range of topics is broad, covering business, health, society, entertainment, sports, and more, the business section is surprisingly robust. There are 134 business publications indexed in the FindArticles database, including *IPO Reporter*, *Journal of Accountancy*, *Kiplinger's Personal Finance Magazine*, *Nation's Business*, *California CPA*, *Mergers & Acquisitions*, and *CFO*. You will also find some local business journals and a selection of trade magazines such as *Outdoor Power Equipment*, *Nation's Restaurant News*, and *Modern Machine Shop*.

The best feature of FindArticles is the price—free: free searching and free full-text downloads of all articles. The worst feature is the "Featured Listings" box that pops up at the top of your search results. Although not identified as such, these are paid listings and in repeated test searches these links were off-topic or to just plain bad sites. ✔

*—**Eva M. Lang**, CPA, is COO of the Financial Consulting Group, Memphis. She is also a contributing editor to* CPA Expert, *a quarterly AICPA newsletter.*

PCPS/ The AICPA Alliance for CPA Firms
Harborside Financial Center
201 Plaza Three
Jersey City, N.J. 07311-3881
(201) 938-3005
Fax (201) 938-3404

ADDRESS SERVICE REQUESTED

Non-Profit Organization
U.S. POSTAGE
PAID
American Institute of
Certified Public Accountants